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Sustainable Firm Performance through Top Management Team Diversity

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Abstract

The integration of various resources within the Top Management Team through diversity is one of the important aspects to enhance the firm performance. Besides, the importance of environmental and social concern has been recognized in achieving sustainable firm performance. Previous scholars suggested that having a diverse TMT is beneficial to the firm and firm performance should be measured through financial, social and environmental aspect in order to achieve sustainable firm performance. Therefore, this study will investigate the influence level of different diversities within the TMT toward firm financial, social, and environmental performance.

INTRODUCTION

The importance of diversity for better performance has been increasingly acknowledged. Diversity in respect to race, gender, ethnicity, nationality, tenure, educational level and functional level has gradually been the concern of organizations (Carson, Mosley & Boyar, 2004). Based on Triandis, Kurowski, Gelfand and Triandis (1994), diversity refers to “any attribute that humans are likely to use to tell themselves, ‘that person is different from me,’”. This concern of the importance of diversity within the firm has filtered its way up to the top leaders (Top Management Team) who represents the highest levels of firms. While Top Management Team (TMT) members has been underlined as the key contributors to the development of firm sustainability which includes financial, social and environmental benefits simultaneously (Lampikoski, Westerlund, Rajala & Moller, 2014), TMT members which are more diverse will possibly benefits and enhance firm outcome especially in contributing to better decision-making, higher innovation and greater creativity (Carson et al., 2004). Referring to the concept of upper echelon theory which usually has been adopted to attach managers’ characteristics and behaviors with organizational results, top managers’ and decision makers’ characteristics have a substantial effect on firm performance (Hambrick & Mason, 1984). Therefore, it is expected that having a more diverse TMT will leads to better firm performance.

OVERVIEW OF THE STUDY

At the moment the industrial nations of the world are featuring substantial challenges and opportunities due to globalization. Additionally, the business settings are intensely revolving and competition is rising stronger every day (Ulrich, Brockbank, Younger, Nyman & Allen, 2009). Since globalization has taken place, industry has grasped incomparable growth and change and such industrial growth has caused social and environmental concerns that have provoked receptions from the administrative authorities as well as from the public in various countries (Fischer & Sawczyn, 2013). Therefore, the upsurge of the environmental and social responsiveness awareness has shifted the importance of performance from financial focus to more comprehensive which includes financial and nonfinancial aspects.

In such competitive environment, Top Management Team has been posited as a potential determinants of firm sustainable performance. Based on Carson, Mosley and Boyar (2004), Top Management Team characteristics has been recognized as impact factor of firm decisions and thus firm performance. Furthermore, it is argued that for long-term sustainability of a firm, Top Management Team members are the vital contributors to the development of firm sustainability that implements “the triple bottom line” of financial, social, and environmental benefits simultaneously (Lampikoski, Westerlund, Rajala & Moller, 2014) and the differences within the TMT is more likely to craft unique value due to the robust combined organization where it offsets weaknesses, thus generating competitive advantage (Carson, Mosley & Boyar, 2004). Hence, researchers and practitioners are concerned about, how a diverse TMT relates to firm performance.

PROBLEM STATEMENT

Objective to boost the performance has been demonstrated in most studies because it inquires the understanding on competitive survival of an organization and response from its environment adaptation (March & Sutton, 1997). Besides, the importance of corporate sustainability for firm competitive advantage has been underlined by researchers (Cacioppe, Forster & Fox, 2008; Eweje, 2011; Muhamad & Auzair, 2014). In addition, it has been argued that in order to achieve sustainable development, scholars have emphasized the need of measuring firm performance beyond the financial aspect where firms need to address three measurements of corporate performance which are financial, social and environmental (Elkington, 1998; Fauzi, Svensson & Rahman, 2010). However, review on previous available demonstrates most of the studies on firm performance related to diversity mainly considered the financial aspect of the performance while it is being stressed that firm performance should also include other aspects of performance besides financial traits such as social performance and environmental performance. Therefore, Fauzi, Svensson and Rahman (2010) suggested future studies in evaluating firm performance should focus on this triple bottom line concept which covers financial, social and environmental aspects to attain sustainable firm performance.

Looking at the importance of sustainable firm performance, Hambrick and Mason (1984) emphasized that firm performance is the result of organization strategic ranges made through the influenced of top management team (TMT) structure. As the importance of firm's top leaders are widely recognized, strategic decisions and choices made by TMT are believed as relatively influenced by the managers' characteristics (Hambrick & Mason, 1984). While correlation among TMT diversity and firm performance has been examined in previous studies, studies have shown a strong association of firm performance with the TMT diversity (Cannella, Park & Lee, 2008; Hambrick & Mason, 1984; Talke, Salomo & Kock, 2011; Williams & O'Reilly, 1998).

Understanding the importance of the TMT role especially in terms of diversity, previous studies have looked into different types of TMT diversities such gender, age, educational background, tenure, functional responsibility as well as working and industry experience (Eisenhardt & Schoonhoven, 1990; Erhardt, Werbel & Shrader, 2003; Manolova & Manev, 2006; Richard, 2000; Schweiger, Sandberg & Ragan, 1986; Talke, Salomo & Kock, 2011). However, these studies have examined the influence of different aspect of diversity separately as independent variables in the western contexts. In addition, studies which have examined such relationships are still limited particularly in Malaysia. Consequently, there is still lack of study which examine these frequently studied diversities in one study. Therefore, current study will look into different TMT diversities (age, gender, race, educational background, functional background, working experience and industry experience) together to test their relationship with firm performance in the Malaysian context.

From the above discussion, it can be concluded that it is important to examine the influence of a comprehensive TMT diversity towards firm sustainable performance. Thus, this study will test the influence of different diversities of the TMT on firm performance in the Malaysian context. Therefore, this study proposes to examine the influence level of TMT diversity on firm financial, social and environmental performance.

LITERATURE REVIEW

Firm Performance

Firm performance has been focused and explained from various perspectives and it grows according to organization context and it focuses on work, people, organizational structure, organizational ability to exploit resources and ability of organization to accomplish its goal (Gavrea, Ilies & Stegorean, 2011). In evaluating firm performance, most corporations are seen to have social, environmental and economic impact which is well-known as sustainability that influence people, communities and the natural environment. Conversely, in many circumstances firm sustainability is explained into three dimensions of firm performances, namely; an economic “financial”, a social “people” and an environmental “planet” performance (Elkington, 1998; Fauzi, Svensson & Rahman, 2010; Sayem, 2012; Wagner & Schaltegger, 2003). Financial performance refers to financial feasibility or the degree to which a firm attains its economic goals (Price & Muller, 1986) and social performance is the “business firms configurations or principles of social responsibility, processes of social responsiveness and policies programs and observable outcomes as they relate to the firm’s societal relationship” (Wood, 1991). Environmental performance, on the other hand refers to the level of effect an organization makes on the natural environment (Moore, 2010).

It has been seen that besides governments and activist, the media and consumers also demand firms to be held more responsible for the social and environmental concerns of their organizational actions (Maas, 2009) resulting a growing volume of firms endeavoring not only for monetary impact, yet they strive for environmental as well as the social effect on the society. However, the notion of social performance is sometimes incorporated underneath the umbrella of social responsibility (Barnett, 2007; Carroll, 1999) and the expressions of social and environment have been enclosed in the notion of social responsibility which means that the environmental aspect is measured as part of the paradigm. Nevertheless, because of the rising significance of environmental issues, it highlights the necessity to discrete the environmental performance from the social performance (Fauzi, Hussain, Abdul Rahman & Priyanto, 2009), and the concept of performance measurements should focus three aspects including financial, social, and environmental (Fauzi, Svensson & Rahman, 2010).

Top Management Team Diversity

It has been observed from previous literature that the impact of top managers is most frequently linked to the entire top management team (TMT) rather than one specific individual (Hambrick, 2007; Hambrick & Mason, 1984). The importance of TMT is undeniable since they are the determinants of firm performance and success (Carson, Mosley & Boyar, 2004). Top managers who are the firm’s main decision makers engage in effective judgments constant by means of their rational frames that have been actually a function of their knowledge, experience, functional background as well as values (Smith, Smith, Olian, Sims, O’ Bannon, & Scully, 1994). Based on Huizingh (2011), TMT members comprised the Chief Executive Officer (CEO), executive directors, and individuals who were, arguably, actively involved in setting the directions for firm strategic decision and policy making. While there has been a considerable amount of indicators on diversity, it can be interpreted in different ways. Jackson, Joshi and Erhardt (2003) describe diversity as a multi-dimensional notion which differentiates among different diversity dimensions.

Study by Abdullah and Ku Ismail (2013) shows that the members from diverse backgrounds enable the team to be balanced and diversity is expected to improve the decision-making because members from various backgrounds having different perspectives are involved in the process. In understanding other types of diversity, Talke, Salomo and Kock (2011) indicate that TMT diversity can also be seen on the base of functional background, educational background, industrial background, and also organizational background. Diverse educational and functional experience of TMT members would likely to produce additional substitutes, and better assess those substitutes as well as progress high quality and artificial clarifications to resolve composite problems (Schweiger, Sandberg, & Ragan, 1986). Furthermore, diversity ensures that there is a broad base of wisdom (Carver, 2002) and take advantage to the differences in making the firm successful (Andringa & Engstrom, 1998). This supports the need of diversity in a firm management and previous studies discussed above demonstrate that a diverse TMT is vital to the firm’s success.

TABLE 1
PREVIOUS STUDIES ON DIVERSITY

Diversity	Previous Studies
Age	Abdullah & Ku Ismail, 2013; Tihanyi et al., 2000; Knight et al., 1999
Gender	Abdullah & Ku Ismail, 2013; Erhardt, Werbel & Shrader, 2003
Race	Abdullah & Ku Ismail, 2013; Erhardt, Werbel & Shrader, 2003; Richard, 2000; McLeod, Lobel & Cox, 1996
Function	Talke, Salomo & Kock, 2011; Carnella, Park & Lee, 2008; Certo et al., 2006; Knight et al., 1999; Hambrick, Cho & chen, 1996; Schweiger. Sandberg & Ragan, 1986
Education	Talke, Salomo & Kock, 2011; Certo et al., 2006; Kemp, Folkerlinga, Jong & Wubben, 2003; Tihanyi et al., 2000; Knight et al., 1999; Hambrick, Cho & Chen, 1996; Schweiger, Sandberg & Ragan, 1986
Industry Experience	Talke, Salomo & Kock, 2011; Smith et al., 1994; Eisenhardt & Schoonhoven, 1990
Working Experience	Talke, Salomo & Kock, 2011; Tacheva, 2007; Certo et al., 2006; Tihanyi et al., 2000; Knight et al., 1999; Hambrick, Cho & Chen, 1996

There are multiple types of diversity that has previously discussed in studies of the relationship of diversity. TMT diversity positively leads to the quality of planning process due to the availability of heterogeneous groups and quality of planning process actually brings the effective problem solving in diverse and complex situations (Talke, Salomo, & Kock, 2011). Hence, previous studies have emphasized on the importance of TMT diversity which in point of fact shows the strong need of a diverse TMT in ensuring better strategic decision making for sustainable competitive advantage. The possible explanation of the fact is that the heterogeneity of TMT members reproduces individuals with diverse knowledge, skills and expertise which can bring diversified thinking rationalities and enthusiasm besides interests. Therefore, it shows the greater diverse background of TMT may leads to better performance. For this study purposes, TMT diversity refers to the heterogeneity of the firm TMT characteristics which include their age, gender, race, level of education, working experience, industry experience, and functional background.

Firm Performance and Top Management Team Diversity

Scholarly focus on the top management team (TMT) stems from the argument that decision makers confer, exchange ideas, and make decisions as a group. As such, significant amounts of research have concentrated on the consequences of various forms of TMT diversity on firm performance (Certo, Lester, Dalton & Dalton, 2006; Knight, Pearce, Smith, Olian, Sims, Smith & Flood, 1999; Tihanyi, Ellstrand, Daily & Dalton, 2000). Mainly, it is the obligation of management to expand firm's performance since performance is the main concern of the stakeholders especially regarding firm's financial performance. Based on Cornell and Shapiro (1987), a firm can potentially achieve increased sales, decreased costs, reduced financial risk, higher amount of investments from financial markets, and improved reputation, all of which will ultimately increase returns and firm's financial performance. Besides, as greater financial performance brings on the growth in wealth of the shareholders, Dean (1999) claims that better financial performance will contribute to better opportunities to improve social performance. Therefore, diversity potentially benefits firm financial performance as well as non-financial performance.

Looking at the importance of diversity on firm outcome, previous study has shown gender and ethnic diversities is associated positively and significantly with a firm's financial performance (Erhardt, Werbel & Shrader, 2003). Besides, it is clearly shows that diversity is crucial to firm where racial diversity affect performance and within a proper context, it could lead to a firm gaining competitive advantage (Richard, 2000). Based on research evidence, it shows that age diversity is also important because having members within the same age group will lead to a biased decision-making styles (Abdullah & Ku Ismail, 2013) and having additional female members essentially pay more devotion to inspection and risk omission and control (Abdullah & Ku Ismail, 2013). Beside gender diversity, having people from different cultures in a group leads to high quality, more effective and feasible ideas than having people predominantly from the same culture in a group (McLeod, Lobel & Cox, 1996). Likewise, the inclusion of various ethnic groups is vital because having members from different ethnic backgrounds will amplifies the team's perspective which would be useful in designing firm strategies through their contribution which are based on different knowledge they have (Abdullah & Ku Ismail, 2013). These previous studies have shown the importance of a diverse group members especially in contributing to better firm's performance. With diverse team, various valuable perspectives and knowledge can be gathered for a better decision leading to better firm performance.

METHODOLOGY

In order to achieve the objectives of this study, the influence level of different diversities among the TMT towards firm performance will be investigated using the Rasch Measurement Model analysis. Based on the above discussion, a more diverse TMT in terms of age, gender, race, education, function, working experience and industry experience offers opportunities for integration of vast resources which potentially beneficial to the firm. Therefore, this study will investigate the influence level of these different diversity on firm financial, social and environmental performance among companies invested by Permodalan Nasional Berhad (PNB) Malaysia.

SIGNIFICANCE OF THE STUDY

It is expected that the originality of this study will be judged through its contribution in the extending to the body of knowledge of upper echelon theory in general and in top management team and firm performance literature in particular. Besides, this study is extended by using advance statistical analysis which in particular is the Rasch Measurement Analysis in order to enrich a better understanding of different dimensions intensity based on the respondents' abilities. Therefore, a better understanding on the influence level of different diversity on firm performance can be attained. The findings of this study may shed lights to firms wanting to find solution towards attaining sustainable firm performance through their top leaders. The findings from this study may provide guidelines on the best practice of appointing top management leaders from various backgrounds identified to achieve sustainable firm performance which includes financial, social and environmental performance.

CONCLUSIONS

Based on the above discussion, it can be concluded that TMT plays an important role in achieving sustainable firm performance. Besides, a more diverse TMT will potentially contribute to better firm performance. Therefore, the influence level of different diversity of the TMT on firm performance which includes financial, social and environmental performance should be looked into. The findings thus can help firms in making more informed decisions about the firm's top management leaders who encourage and enrich firm performance.

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